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IN THE

Supreme Court of the United States

OCTOBER TERM, 1933.

No. 64.

AMY ARZT and JOSEPHINE RAMSEY,
Petitioners,

vs.

RUDOLPH B. FLERSHEM, CHARLES O. CORNELL, JOHN H. WATERS, et al., etc.

PETITIONERS' BRIEF.

DAVID M. PALLEY,
of New York, N. Y.,

CHARLES H. SACHS,
LOUIS CAPLAN,
of Pittsburgh, Pa.,
of Counsel.

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RUDOLPH B. FLERSHEM, CHARLES O. CORNELL, JOHN H. WATERS, et al., etc.

PETITIONERS' BRIEF.

This case comes to this Court on a writ of certiorari to review a decree of the United States Circuit Court of Appeals for the Third Circuit, entered on March 24th, 1933, affirming a decree of the United States District Court for the Western District of Pennsylvania, dated September 8th, 1932, made by Judge Gibson confirming the sale, by receivers, of the assets, property and business of the National Radiator Corporation, a Delaware corporation, directing the receivers to deliver to the purchaser a deed thereto and approving the plan of reorganization of the company.

Opinions of the Courts Below.

The opinion of the United States Circuit Court of Appeals for the Third Circuit is reported in 64 F. (2d) 847. The opinions of Judge Gibson are not reported but appear in the record at pages 280 and 463.

Jurisdiction.

The decree of the United States Circuit Court of Appeals was entered in the office of the Clerk of the United States Circuit Court of Appeals for the Third Circuit on March 24th, 1933 (R., 547).

Jurisdiction to review this case is found in the provisions of Section 240-A of the Judicial Code as amended by the Act of February 13, 1925, c. 229, Sec. 1, 43 Stat. 938; 28 U. S. C. 347.

Statement of the Case.

The petitioners challenge the jurisdiction of the District Court in this case and impugn its right to appoint receivers, sell the assets and approve the plan of reorganization of the respondent, National Radiator Corporation (Del.).

On October 5th, 1931 (R., 6), the respondents, Rudolph B. Flershem, Charles O. Cornell, John H. Waters and Frank B. Cahn, as the Reorganization Committee constituted under the Plan and Agreement, dated February 11, 1931, for the Reorganization of National Radiator Corporation, filed, in the District Court of the United States for the Western District of Pennsylvania, a bill of complaint against the National Radiator Corporation in which they prayed (R., 12-14) for the appointment of receivers of said corporation, the sale of its assets and the distribution of the proceeds. On October 9th,

1931 (R., 63), the National Radiator Corporation appeared in the cause, admitted the allegations of the complaint and joined in the prayer for relief, and the court appointed Robert S. Waters and William G. Heiner receivers (R., 65).

The action was not brought on the ground that the corporation was insolvent or in imminence of insolvency.

Although the bill declares that intervention by the court was necessary to prevent "a multiplicity of suits, a race of diligence, wasteful strife and controversy" (R., 11), the fact is that on October 5th, 1931, the company was solvent and amply able to pay *in full, in cash*, every debt as it matured in regular course.

The jurisdiction was invoked solely for the purpose of effectuating a reorganization of the company in order to scale its funded debt and to coerce non-assenting debentureholders into subjection to the plan or else to wipe them out.

On August 8th, 1932 (R., 372), the cash, property and business, including the good-will of the company as a going concern (R., 297), were, pursuant to decree of the District Court (R., 283-329), sold for the sum of $2,550,000.00 (R., 375), the purchase being made in behalf of the Reorganization Committee under the Reorganization Plan (R., 370).

The petitioners, who jointly hold $121,000.00 (R., 483; 487) principal amount of the company's debentures, were not parties to the cause, but on the 18th day of August, 1932 (R., 389), at a hearing set therefor (R., 299), they appeared specially and opposed the confirmation of the sale on the ground that the court had never acquired jurisdiction over the subject-matter of the cause and therefore was without power to order the sale or to confirm it (R., 483; 486). The District Court overruled the objection, confirmed the sale and approved the plan of reorganization (R., 463); the Circuit Court of

Appeals affirmed the decree of the District Court (R., 545; 547).

The National Radiator Corporation (Del.) (R., 7), was engaged in the business of manufacturing and selling heating appliances, boilers and radiators (R., 10).

It was formed in August of 1927, by the merger of six companies (R., 33; 275), with assets valued at upwards of $26,000,000.00 (R., 274) and with a capital stock and surplus of $12,714,200.00, consisting of 60,000 shares of $7.00 cumulative preferred stock of no par value, and 270,000 shares of common stock also of no par value (R., 274).

In connection with this merger, the company on August 30th, 1927, authorized an issue of $16,000,000.00 principal amount, 6½% Sinking Fund Gold Debentures (R., 7; 106), and pursuant to that authority, there was issued $12,000,000.00 of said debentures (R., 8; 106). *The debentures were payable on August 1st, 1947,* and provided for the payment of interest, semi-annually, on the first days of February and August in each year, at the rate of 6½% per annum (R., 16). The terms and provisions governing their issue and the appurtenant interest coupons, as well as the rights and remedies of the holders of debentures, are set forth in an Indenture (R., 15-32) (Schedule A annexed to the Bill [R., 15]), made between the company and the Bankers Trust Company, a New York corporation, as Trustee (R., 7-8; 15).

The debentures were underwritten and sold by the Bankers Trust Company and J. & W. Seligman & Company, New York bankers, who jointly sponsored the merger (R., 251; 275).

On February 1st, 1931, the National Radiator Corporation refused to pay the installment of interest which then became due upon the debentures (R., 32-33; 109) of which there were then outstanding $10,716,000.00 principal amount (R., 34).

The refusal to pay the interest was not because of lack of funds.

In the latter part of 1930 (R., 417), John H. Waters, President and Chairman of the Board of Directors, and Rudolph B. Flershem, Chairman of the Executive Committee, had decided upon a reorganization of the company in order to scale its funded debt (R., 35; 251). Thereupon, after consultation with the Bankers Trust Company and J. & W. Seligman & Company (R., 251; 417), Waters and Flershem appointed themselves and one Charles O. Cornell, a Reorganization Committee (R., 251; 500), and with the approval of the Bankers Trust Company, the Trustee of the debentures, decided, as part of the plan to reorganize, not to pay the installment of interest which would become due on February 1st, 1931 (R., 251; 417-418; 500-501).

On January 31st, 1931, the Board of Directors ratified the action of Waters and Flershem. The Board of Directors agreed with its Chairman (R., 500):

> "• • • that, although the cash working capital of the Company as shown by the balance sheet was reasonably ample, it was evident that, if the Company were to do an increasing volume of business, it would require the use of all or a substantial part of this cash to carry larger inventories and receivables, and that it would also be necessary to make large expenditures for the design of new products and for equipment necessary in their manufacture. Otherwise, the Chairman pointed out it might well prove to be impossible to maintain the Company's competitive business as against other enterprises in the industry."

There was submitted to the Board at that meeting a financial statement of the company as of December 31st, 1930, just one month before. A copy of the statement

is contained in the Plan and Agreement (annexed as Exhibit B to the bill of complaint [R., 32-63]). That statement (R., 34-35) discloses that the net worth of the company on December 31st, 1930, was $8,134,643.01—its assets were $19,434,548.08, and its liabilities, including the outstanding debentures, $11,299,905.07.

Especially noteworthy and impressive is the statement of its current assets and its current liabilities. On December 31st, 1930, the quick current assets of the National Radiator Corporation were $5,054,007.30 *and $1,701,899.94 of that was cash.* And its current liabilities at that time were only $491,895.72 (*only $46,787.60 was presently due*) and included therein was $293,339.58 accrued interest upon the outstanding debentures, computed to December 31st, 1930.

The ratio of cash to current liabilities was 3½ to 1, and of current assets to current liabilities was more than 10 to 1.

It is indubitably apparent that on February 1st, 1931, the company could have paid all its current and maturing debts, including the interest on its outstanding debentures, out of the cash alone and there would still have remained in cash about $1,200,000.00, and none of the other current assets would have been affected. The company was manifestly solvent and liquid and its refusal to pay the interest upon its outstanding debentures was unconscionable.

On February 11th, the Reorganization Committee promulgated a plan of reorganization (R., 32) and appointed the Bankers Trust Company, the Trustee of the debentures, depositary under the plan (R., 47; 109). This committee inaugurated by and acting in behalf of the company, purports to represent debentureholders, preferred stockholders and common stockholders (R., 343).

However, the plan is all in the interest of the company, discriminates against debentureholders in favor

of other creditors of equal rank, contains no provision for any new capital and makes no provision for non-assenting debentureholders.

The plan contemplates the organization of a new company to which is to be transferred all the assets of the old corporation including the cash (R., 37). The capital structure of the new corporation is as follows (R., 37):

	Authorized	*To be Presently Outstanding*
15-Year 5% Debentures	$5,500,000	$5,358,000
$7 Preferred Stock (no par value)	55,000 shares	53,580 shares
Common Stock (no par value)	400,000 shares	272,966 shares

The new debentures bear interest at the rate of 5% per annum which, however, is payable only out of income (R., 38).

The plan gives to each holder of $1,000.00 principal amount of old debentures $500.00 principal amount of new debentures, 5 shares of new preferred stock and 20 shares of new common stock (R., 40-41).

Merchandise and service creditors are to be paid in full by the new company, unless they shall have previously been paid by the old company (R., 37).

The holders of the present preferred stock are to receive, share for share, common stock of the new corporation (R., 41). Holders of the present common stock are to receive stock warrants of the new company in the ratio of 1 to 3, namely, one stock warrant of the new company for each three shares of common stock of the old company, upon payment, *to the Reorganization Committee,* of $1.00 for each warrant issued (R., 41). The holders of the warrants are entitled to purchase, *on or*

before July 1st, 1941, shares of common stock in the new company upon payment of $20.00 per share (R., 40).

There is no provision for any assessment upon the preferred stockholders and the holders of stock warrants have until the 1st day of July, 1941, to decide whether to exercise their options or not.

Although the preferred stock is issued without par value, the holders of such stock upon involuntary liquidation are entitled to $100.00 a share, and on voluntary liquidation to $115.00 a share, thus placing the value of $100.00 a share upon said stock (R., 39-40).

The common stock is also without par value but the valuation placed on that stock in the scheme of reorganization is $20.00 per share, the price at which it may be purchased, by the holders of warrants, on or before July 1st, 1941 (R., 40).

Giving effect, therefore, to the valuations placed on the securities to be issued, the capital of the reorganized corporation is $16,175,320.00, which is made up as follows:

15-Year 5% Debentures	$5,358,000.00
$7 Preferred stock no par value at $100.00 per share	5,358,000.00
272,966 shares at $20.00	5,459,320.00
Total	$16,175,320.00

The plan met with opposition. A committee, known as the Bondholders' Protective Committee, purporting to represent debentureholders only was formed (R., 383-386). And of that committee, Frank B. Cahn, one of the complainants and who later became a member of the Reorganization Committee, was a member (R., 386; 503). That committee unanimously condemned the management of the company as incompetent (R., 386), denounced the plan as unjust to debentureholders and

urged debentureholders not to deposit under the plan but to aid in their opposition to it by depositing their debentures with them. There was deposited with that committee in excess of $851,000.00 principal amount of debentures of holders who were opposed to the plan (R., 503).

On September 15th, 1931, the two committees arranged a settlement between themselves (R., 503-510). The Bondholders' Protective Committee agreed to deposit, under the Reorganization Plan, the debentures deposited with them (R., 507), and the Reorganization Committee agreed to allow the Bondholders' Protective Committee $35,000.00 for compensation, counsel fees and expenses of that committee (R., 508); to elect one of the Bondholders' Protective Committee to the Reorganization Committee (R., 508); and to make one of that committee a member of the Board of the new company (R., 509).

On September 15th, the same day, the Reorganization Committee declared the plan operative (R., 362). About 81% of the outstanding debentures had been deposited with the Reorganization Committee (R., 362) and about 9% with the Bondholders' Protective Committee (R., 366).

On September 17th, 1931, Frank B. Cahn, a member of the Bondholders' Protective Committee, was pursuant to the terms of the settlement, elected a member of the Reorganization Committee (R., 512).

But there were still holders of upwards of $1,000,000.00 principal amount of debentures who had not deposited with either Committee and who refused to assent to the plan of reorganization.

The Indenture provides that in the event of a sale by the company of its property as an entirety, the obligations of the debentures shall be assumed by the purchaser (R., 30-32). It is therefore obvious that unless the new company was willing to assume the obligations of the debentures held by non-assenting debenturehold-

ers, it was necessary to find a means for transferring the property of the National Radiator Corporation to the new company, free from those obligations.

Some of those non-assenting debentureholders insisted upon the payment of the February 1 and August 1, 1931, installments of interest and when payment was refused, brought suit (R., 512). Thereupon, on October 1st, 1931, the Reorganization Committee, two of whose four members were officers and directors of the National Radiator Corporation, met and agreed upon the course of action to "be pursued not only to forward the purposes of the Reorganization Plan but also to prevent a multiplicity of suits against National Radiator Corporation" (R., 513).

The avowed purpose was to prevent non-assenting debentureholders from collecting their interest and either to force them into the plan or else to wipe them out. It was therefore decided that the Bankers Trust Company as depositary should demand the payment of interest upon the deposited debentures and upon refusal, a bill of complaint should be filed by the Reorganization Committee against the National Radiator Corporation (Del.) in the District Court of the United States for the Western District of Pennsylvania, praying for the sale of the assets and the appointment of receivers (R., 513-514).

That was done.

On October 2nd, 1931 (R., 110; 525), the Bankers Trust Company as depositary wrote a letter to itself as paying agent, demanding the payment of the interest, and then notified (R., 511) the Committee that payment was refused for the reason that there were no funds on deposit with it, as paying agent, with which to make such payment (R., 110). Thereupon, on October 5th, 1931 (R., 6), the bill was filed and on October 9th, 1931 (R., 63), the National Radiator Corporation appeared, consented to the decree which was entered, and William G. Heiner, an attorney, and Robert S. Waters, Vice-President and General Manager of the

National Radiator Corporation and a son of John H. Waters, its President and Chairman of its Board of Directors and a member of its Reorganization Committee, were appointed receivers of that company (R., 65).

An analysis of the bill which was filed is contained in our brief in the companion case of *Clapier* v. *Flershem, et al.*, No. 65.

At the October 1st meeting (R., 512), it was also decided that the Bankers Trust Company as Trustee should, after demand and refusal, sue and recover judgment for the February 1st and August 1st, 1931, installments of interest upon all the outstanding debentures (R., 513). Accordingly, on October 9th, 1931 (R., 111), the Bankers Trust Company as Trustee demanded the interest and upon refusal, it did, on October 13th, 1931, institute suit and recover judgment for $713,944.38 (R., 526).

A reading of the Indenture will make the reason for that demand and suit quite plain. The debentures and appurtenant coupons contain the provision that the rights of the holders are subject to the terms and provisions of the Indenture (R., 17), and the Indenture contains the following provision (Article V, Section 9, R., 30):

> "All rights of action under this Indenture, or under any of the debentures or coupons, may be enforced by the Trustee without the possession of any of the debentures or coupons or the production thereof on any trial or other proceeding relative thereto, and any such suit or proceeding instituted by the Trustee shall be brought in its name as Trustee, and any recovery of judgment shall be for the ratable benefit of the holders and registered owners of all of the debentures and coupons, except as provided in Section 2 of Article IV hereof, and Section 1 of this Article."

The purpose of the suit and recovery of judgment by the Bankers Trust Company was to enable the National

Radiator Corporation to plead that judgment as a bar to suits for interest by non-assenting debentureholders (R., 420-421).

That very defense was interposed and upheld in a suit brought by one Rae Berger against the National Radiator Corporation in the City Court of the City of New York, County of New York (R., 420).

On October 5th, 1931, the company was solvent and able to pay all its obligations then due and payable—*in cash, in full.* The company was both solvent and liquid.

A statement of the company's assets on October 8th, 1931, is contained in the Record at page 521:

The assets are valued at	$11,944,244.38
This does not include Good-will, Trade Marks and Patents (R., 523)	6,634,501.90
which would make the total assets	$18,578,746.28

But what is especially interesting and noteworthy is the statement of current assets. A summary of those assets is as follows (R., 521-522):

Cash		$1,257,381.59
Notes and Accounts Receivable	$1,673,373.59	
Less Reserve for Bad Debts and Doubtful Notes and Accounts Receivable	179,046.37	1,494,327.22
Inventory		2,048,901.97
Stocks and Bonds		104,582.36
Life Insurance Policies (Cash Surrender Value)		18,984.00
New York State Highway Bonds		15,550.40
Total		$4,939,727.54

The statement does not set forth the liabilities, but the Decree does (R., 294). Besides the $10,673,000.00 (R., 108) outstanding debentures which were not payable before August 1st, 1947, the liabilities were:

Past Due Interest on Debentures (R., 294)		$709,395.69
Other Debts (R., 295)		157,511.89
Total		$866,907.58
In addition there was due August 1, 1931 (R., 108) a Sinking Fund payment of	$201,918.50	
Against which the company surrendered bonds in the aggregate principal amount of $158,000.00 (R., 108), for which it was entitled to a credit at the redemption price (R., 279) of 107½ (R., 18), i. e.	169,850.00	
Leaving due on account of Sinking Fund payment		32,068.50
Making the total debts due on October 5, 1931		$899,076.08

It is manifest that the company on October 5th, 1931, could have paid all its current debts, including the overdue interest upon all the debentures, out of the cash alone and there would still have remained, *in cash*, almost $400,000.00, and none of the other current assets would have been affected.

Almost the very first official act of the Receivers, after they assumed the operation of the business of the company, was to disavow the statements of the bill and the findings of the District Court. The complaint alleged (R., 11) and the court found that the National Radiator Corporation is (R., 65) "presently unable to meet and discharge its obligations which have already matured, without seriously jeopardizing the ability * * * to continue in business".

On October 23rd, 1931, two weeks after their appointment, the Receivers procured an order (R., 521), authorizing them to invest "such amount or amounts of cash of the receivership estate as, in the judgment of the Receivers, is not needed at the time for expenses and working capital; * * * ".

And thereupon the Receivers proceeded to invest $1,030,000.00 of the company's cash (R., 257),—

$980,000.00 in United States Treasury Certificates of Indebtedness, and
$50,000.00 in Bank Certificates of Deposit.

One million thirty thousand ($1,030,000.00) Dollars—more than was necessary to pay the overdue interest on the debentures and the other debts of the company—the Receivers invested and kept invested in government and bank certificates because it was not needed in the conduct of the business.

The proponents of the reorganization plan were now ready for the transfer of the assets to the new company and on November 28th, 1931 (R., 516), the Reorganization Committee met to decide upon the procedure to be followed to accomplish that end. It was decided that the Bankers Trust Company should declare immediately due and payable, because of the default in the payment of interest, the principal of the outstanding debentures and after demand upon and refusal of payment by the

National Radiator Corporation, should institute suit and recover judgment therefor in the District Court of the United States for the Western District of Pennsylvania, and should thereafter intervene in this cause as a party plaintiff (R., 517-518).

That was done.

On December 24th, the Bankers Trust Company, as Trustee, declared the principal of the outstanding debentures due and on December 30th, 1931, after demand and refusal of payment, recovered judgment (R., 112-114).

Thus we have the spectacle of those who were responsible for the default in the payment of the interest now using that very default as the pretext for declaring the debentures due.

On January 9th, 1932, in conformity with the procedure adopted by the Reorganization Committee, the Bankers Trust Company as Trustee intervened in the cause as a party plaintiff and in its petition of intervention, adopted all the allegations of the bill and joined in its prayer for relief (R., 85).

The interest of Bankers Trust Company in the affairs of the National Radiator Corporation was more than merely that of Trustee.

It was the Bankers Trust Company, in conjunction with J. & W. Seligman & Company, New York bankers, which sponsored (R., 251) the formation of the merger which resulted in the creation of the company, and underwrote and sold (R., 269-280) the debentures to the public. And it took an active and authoritative part in the management of the company's affairs after its creation. It was consulted when one Grant Pierce became President of the company (R., 455), and its consent to the reorganization of the company and passing of the interest on the debentures was first sought and procured (R., 251; 417-418).

In the reorganization of the company, it played a predominant part.

At the November 28th, 1931, meeting of the Reorganization Committee (R., 516-520), certain questions relating to the new corporation came up for consideration. The matters considered were the appointment of:

1. Transfer agent of the stock of the new company.

2. Registrar of the stock of the new company.

3. Trustee of the new debentures.

Mr. Cornell, contact man between the Reorganization Committee and the Bankers Trust Company, reported that it was the wish of the Bankers Trust Company that the Transfer Agency should go to it, the Registrarship to Marine Midland Trust Company, and the Trusteeship to the New York Trust Company.

Thereupon the Committee appointed the Bankers Trust Company Transfer Agent; the Marine Midland Trust Company Registrar; and requested (R., 520):

> "• • • that Mr. Cornell express to Bankers Trust Company the wish of this Committee, to be effective, unless actually disapproved of by Bankers Trust Company, that the Trustee for the new debentures be the Manufacturers Trust Company."

The personnel of the Board of the new company also came up for consideration at that meeting. The Committee requested Mr. Cornell (R., 520):

> "• • • to ascertain of Bankers Trust Company and of J. & W. Seligman & Co. if they had any suggestions to make in respect to membership on said Board of Directors. It was the sense of the meet-

ing that said Board of Directors should consist of twelve members, one of whom would be Mr. Frank B. Cahn and that the remaining members should be persons satisfactory to Mr. Waters and of his nomination, to the extent that circumstances did not require the inclusion of any others."

Frank B. Cahn was to be a director because the Settlement Agreement so provided (R., 509). The other directors were to be appointed by John H. Waters, provided the Bankers Trust Company approved and did not appoint others.

The Bankers Trust Company, the trustee of the debentures under the Indenture, was a predominant participant in the reorganization of the National Radiator Corporation and Charles O. Cornell, apparently, was its representative upon the Reorganization Committee.

At the November 28th meeting there was also considered the upset price. It was the opinion of the meeting that the liquidating value of the National Radiator Corporation was $3,600,000.00 and the distributive value of the debentures $30.00 per $100.00 (R., 518-519).

In March, 1932, the court heard testimony for the purpose of fixing the upset price (R., 133).

No notice of the hearings was given to any non-assenting creditors and, with the exception of the intervener, First National Bank of Cincinnati (R., 133), **none took part in those hearings.**

Nor did the District Court order an appraisal to be made by independent and impartial experts. In fixing the upset price, the District Court relied upon the notions of Robert S. Waters (R., 136-224; 241-249), one of the receivers, Vice-President and General Manager of the company and a son of John H. Waters, President and Chairman of the Board of that company and a member of the Reorganization Committee; of Rudolph B. Flershem (R., 224-241), Chairman of

the Executive Committee of the company and also a member of the Reorganization Committee; of John H. Waters (R., 249-255); and of William G. Heiner (R., 255-266), the other receiver, an attorney at law (R., 255) who, previous to his appointment, had never any experience whatever in the radiator or boiler business (R., 256) and who, with the exception of the Johnstown and New Castle plants, had never visited any of the plants or properties of the company (R., 261). They testified it would be possible to realize for all the assets of the company, including almost $2,000,000.00 of cash, at most $2,300,000.00 (R., 153-154; 230; 231; 258-259). They based their opinions upon the financial condition of the company as of December 31st, 1931. The current assets at that time were as follows (R., 257-258):

Cash	$825,096.29
United States Certificates of Indebtedness	980,000.00
Interest on United States Certificates	6,124.97
Bank Certificates of Deposit	50,000.00
Cash Surrender Value of Life Insurance	22,900.00
Deposit New York Workmen's Compensation Law	18,686.33
Total Cash Assets	$1,929,807.59
Accounts Receivable (less reserve for bad debts, etc., R., 242)	858,992.41
Inventory	1,634,905.25
Total Current Assets	$4,423,705.25

Besides those assets, there were plants, machinery, patents, good-will, trade marks, patterns and investments in affiliated companies, which were carried on the books

of the company at $13,000,000.00 (R., 523) and which, in 1927 when the merger was formed and the debentures sold, were appraised at upwards of $16,000,000.00 (R., 274). Eighteen million dollars of assets were, in their opinion, worth a paltry $400,000.00 over and above the $1,929,807.59 of cash on hand. They explained that the difference between the book value and their alleged appraisals represented the difference between liquidation and a going concern (R., 148; 150; 153-154; 220-221; 223; 227-228; 231; 233; 234; 251).

They justified the appraisals on the ground that there were no buyers (R., 251; 266) and that the property would have to go as "scrap" (R., 251; 257; 263) at "panic" prices (R., 154; 227).

On May 31st, 1932, the court ordered sold all property and interests in property of every kind, character and description, including all the business, good-will, corporate name, patents, trade marks, trade names, bills and accounts receivable, choses in action and *cash on hand or in bank* (R., 297), and fixed the upset price therefor at $2,500,000.00 (R., 326).

The action was instituted by the Reorganization Committee upon its claim for unpaid interest upon the deposited bonds (R., 10); but the decree, however, ordered the sale to enforce the judgments recovered by the Bankers Trust Company (R., 297). The decree directed the payment (R., 296), within ten days, by the National Radiator Corporation or by someone on its behalf of the judgments recovered by the Bankers Trust Company, and in default of such payment (R., 297), directed the sale of the properties.

The proceeds of the sale, after the payment of all the receivership expenses, were ordered distributed to the creditors who are perpetually enjoined from suing the defendant or the purchaser upon any claim due from the defendant (R., 309).

Out of the proceeds merchandise and service creditors are to be paid in full, for the credit and good will of the company must be maintained for the benefit of the reorganization (R., 395; 459).

On August 8th, 1932, the Reorganization Committee purchased the business and assets of the corporation as a going concern for the sum of $2,550,000.00 (R., 367-375).

The purchasers at the sale were Ludington and Resley and they immediately assigned their bids to the National Radiator Corporation (Md.), the new company organized for the purpose of taking over the assets under the reorganization plan.

On August 18th the matters of the approval of the reorganization plan and the confirmation of the receivers' sale came on for hearing and on September 8th the decree confirming the sale and approving the plan was entered (R., 299).

It was evident that the Reorganization Committee would be the only purchaser at the sale and that the so-called sale was held merely for the purpose of appraising the value of the debentures held by non-assenting holders. And upon the basis of the sale price, after deducting the receivership expenses and fees, non-assenting creditors will receive but very little.

The action was instituted in order to preserve the going concern value of the company for the benefit of all creditors.

The complainants alleged (R., 12) that "the going concern value of the defendant's business and properties should be maintained, continued and kept intact *for the benefit of all creditors,* until all of the assets and business of the defendant can be sold as an entirety, *and the complainants believe that this can be accomplished*".

The complainants also alleged (R., 12) and the District Court found (R., 295):

"* * * The unity of the property of National Radiator and its integrity as a whole, as now held and operated, the administrative, technical and sales organization and the good-will of its customers, constitute, however, most important elements of value."

The court ordered sold and the Reorganization Committee purchased a going concern (R., 297). Nevertheless, the District Court held that non-assenting creditors were entitled to their aliquot share of the liquidating value of the assets at a time when there were no purchasers therefor (R., 281-282). The receivership was instituted and continued for the purpose of preserving this going concern value and non-assenting debentureholders are charged with the expenses of that receivership (R., 309), but receive none of the benefits thereof.

Judge Gibson justified the exercise of jurisdiction, in this case, on the ground that the company, because of its large, annual losses, was moving towards bankruptcy and that a reorganization was necessary to prevent that (R., 280).

In that view, the Circuit Court of Appeals concurred (R., 534). That court sustained the exercise of jurisdiction by the District Court on the ground of insolvency —not present insolvency—but possible future insolvency. In its opinion, per Woolley, C. J., the court said (R., 537):

"* * * It is pertinent to note the bill did not say the corporation was insolvent. That, in effect, was a tacit admission or declaration of its solvency. The corporation, by its answer, admitted the truth of all allegations of the bill. Concededly, the corporation was solvent in the sense of having fluid assets enough to pay its debts then due in the usual course of trade—without giving thought to the consequences. * * *"

It, too, was disturbed by the apparent, average annual losses, after payment of interest, of $1,310,000.00 (R., 535) and it foresaw inevitable disaster to the company if the interest payments upon its debentures continued. The opinion of the court continues as follows (R., 539):

> "* * * Here the corporation could presently pay (the interest), but payment foretold imminent consequences disastrous to the corporation and, what is more to the point, disastrous to its securityholders. Plainly those consequences were insolvency with its attendant evils to all concerned. * * *"

That court conceded that the corporation was and would for some time be able to pay the interest upon the outstanding debentures; but in its opinion, the continued payment of the interest presaged insolvency for the corporation some time in the future and on that ground sanctioned the intervention of a court of equity.

It cannot be denied that the National Radiator Corporation was operating at a loss, but those losses were not as great as they might, on paper, appear. The greater part of those losses were bookkeeping losses; the cash losses were considerably less. Included in the $1,310,000.00 of average annual losses found by the Circuit Court of Appeals (R., 535) were charges for depreciation, reserves for bad debts and other deductions which consumed none of the company's cash. In the Record (R., 498), is a statement of earnings of the company for two twelve-month periods ending September 30th, 1930 and 1931, respectively, and in that statement the various items of loss are segregated. An analysis of these statements will prove our point.

1930.

Operating income	$308,950.00
Other income	73,195.00
Total	$382,145.00
Interest	721,948.00
Cash loss for 1930	$339,803.00

1931:

Operating income (deficit)	$29,146.00
Other income	52,281.00
Net income	$23,135.00
Interest	697,157.00
Cash loss for 1931	$674,022.00

It is quite evident that the actual cash losses sustained by the company were considerably less than the apparent, average, annual losses and that the company was financially able to withstand them.

Specification of Errors.

Petitioners rely upon the Specification of Errors set forth in the brief submitted in support of the Petition for the Writ of Certiorari, which are as follows:

1. The Circuit Court of Appeals erred in affirming all orders and decrees of the District Court appealed from.

2. The Circuit Court of Appeals erred in not reversing the decrees of the District Court, dated October 9th,

1931, May 31st, 1932 and September 8th, 1932, as to the petitioners and all other creditors who did not assent to the plan of reorganization.

3. The Circuit Court of Appeals erred in holding that jurisdiction over the subject matter of the cause existed and was properly exercised.

4. The Circuit Court of Appeals erred in holding that the exercise of jurisdiction in this cause did not constitute a taking of property without due process of law in violation of the Fifth Amendment of the Constitution of the United States.

Summary of Argument.

The exercise of jurisdiction in this cause marks a departure from the accepted principles of law governing equity receiverships; violates the fundamental rules of property and rights of creditors; and constitutes a taking of property without due process of law in violation of the Fifth Amendment of the Constitution of the United States.

It is a fundamental principle of our jurisprudence that the property of a debtor should be applied to the payment of his debts. To that end our courts—law and equity—are invested with power to sell the property of an unwilling debtor and to distribute the proceeds to his creditors; but payment may not be demanded nor the power invoked before the debt is due.

The creditor has not the right of selection and if the property available to legal process be sufficient to discharge the debt, no appeal to equity lies. The appeal, whether to law or equity, is for the enforcement of payment through the power of sale and distribution.

Equity, however, will not exercise its jurisdiction except where the legal remedy is inadequate.

The assets of an insolvent corporation are deemed held in trust for the benefit of its creditors and equity will take jurisdiction to administer that trust. This trust doctrine has been extended also to corporations in imminence of insolvency; corporations which though solvent would be rendered insolvent if all creditors with debts presently due and maturing should insist upon immediate payment.

Jurisdiction, however, depends upon the right to enforce payment through its power of sale and distribution. It is distinctly a creditors' remedy for the enforcement of creditors' rights. The reason underlying its exercise is the rule of distribution ratably amongst creditors of the corporation.

Receivership is an ancillary remedy granted—pending sale—to prevent the acquisition of priority and preference in such distribution.

Reorganization is but an incident of the exercise of that power. It is a combination of persons with similar interests and whose interests are equitably adjusted to purchase the property at the sale and to use such property after purchase to their mutual advantage. The *raison d'être* of the remedy, however, is the enforcement of payment and not reorganization.

It is therefore essential to the exercise of jurisdiction that the corporation be insolvent or be in imminence of insolvency; that it have debts presently due and payable but which it is unable to pay. The mere refusal to pay does not confer jurisdiction upon the court; there must be debts now due and the inability to pay them.

That essential element is manifestly lacking in this case. The power of sale and distribution was usurped for the purpose of hindering and delaying creditors and absolving the corporation from debts not yet due and

not maturing until 1947. Reorganization was the primary relief sought and the power of sale was the means adopted for its accomplishment. Jurisdiction was assumed and retained not because of present insolvency through inability to pay debts presently due and maturing, but because of possible future insolvency through the possible inability in the future to pay debts which would then mature. Such a doctrine substitutes conjecture for accepted principles of law. It is without precedent.

If possible future inability to pay debts not yet due can be laid as a basis for the use of the power of sale and distribution, then such rule should be available to the creditors as well as the debtor. Clearly, over the objection of the National Radiator Corporation which was able to pay its debts present and maturing in full, in cash, such a right would not be allowed.

Jurisdiction cannot be conferred by consent, nor can a debtor by collusion with a friendly creditor and an obliging trustee effect a transfer of its assets and a commutation of its debts. The granting of a remedy where no right thereto exists constitutes a denial of due process of law to those who are prejudiced thereby.

Because in the proper case a reorganization may result from the assumption of jurisdiction by a court of equity that does not justify the exercise of jurisdiction where the basic essential elements do not exist.

The petitioners submit:

I. The suit was collusively brought for the purpose of coercing non-assenting debentureholders into subjection to the plan or else to wipe out their rights under the debentures and under the Indenture governing their issue.

II. A court of equity may not exercise its power of sale and distribution over a corporation which is solvent

and able to pay its debts as they mature in regular course, in order to effectuate the transfer of those assets to a new company free from the obligations of the old.

III. A court of equity may not exercise its power of sale and distribution over a corporation which is solvent and able to pay its debts as they mature in regular course, for the sole purpose of enabling it to scale its funded debt through reorganization.

IV. The court lacked jurisdiction, and the exercise of jurisdiction by it in this case constituted a taking of property from non-assenting creditors without due process of law, in violation of the Fifth Amendment of the Constitution of the United States.

Argument.

I.

The suit was collusively brought for the purpose of coercing non-assenting debentureholders into subjection to the plan or else to wipe out their rights under the debentures and under the Indenture governing their issue.

In its petition of intervention the First National Bank of Cincinnati charged (R., 95) that "the original complainants herein * * * filed their said Bill of Complaint for the purpose of bringing about the receivership herein as a step in effectuating said plan" (of reorganization), and in their answer to that petition, the complainants admitted (R., 99) that "they filed the Bill of Complaint in this cause as a step in effectuating the Plan and Agreement of Reorganization dated February 11, 1931".

Concededly, the avowed purpose of the suit was to effectuate a reorganization of the company; and, admittedly, all things done were done towards accomplishing that result.

As to holders who had, by the deposit of their debentures, assented to the reorganization, the suit was not necessary. *Between the Reorganization Committee and the National Radiator Corporation no controversy existed. Both had decided upon reorganization and had agreed upon the plan to be adopted.*

On September 15th, 1931, the plan was declared operative (R., 362), and all that remained to be done was to organize a new company, transfer to it the assets of the old and distribute to those who had assented the new securities in exchange for the old.

The objection to that course, however, was that non-assenting debentureholders would be entitled either to the redemption of their debentures or else to an assumption of those debentures by the new company (R., 30-32). That did not coincide with their designs.

The only controversy was between the parties to the cause and the dissenting debentureholders. The purpose of the suit was to prevent the dissenting debentureholders from enforcing their rights and to compass the transfer of the assets, business and properties of the National Radiator Corporation free from the obligation to them.

Non-assenting debentureholders must be forced into the plan or else wiped out.

But the company was solvent.

The statement, by the Circuit Court of Appeals, that the National Radiator Corporation was insolvent within the definition of the Bankruptcy Act (R., 537) is untenable. That statement was based upon the upset price of $2,500,000.00 and the sale price of $2,550,000.00 (R., 536).

The Bankruptcy Act, Sec. 1 (15), Act of July 1, 1898, c. 541, 30 Stat. 544, defines insolvency as follows:

> "A person shall be deemed insolvent within the provisions of this Act whenever the aggregate of his property * * * shall not, at a fair valuation, be sufficient in amount to pay his debts;"

The National Radiator Corporation was a going concern and a fair valuation of its assets as a going concern is not the scrap value (R., 263) in liquidation at panic prices in the midst of a world-wide depression.

Geddes v. *Anaconda Copper Mining Co.*, 254 U. S. 590, 601.

In re Bucyrus Road Machinery Co., 10 F. (2d) 333.

Suring State Bank v. *Giese, et al.*, 210 Wis. 489, 246 N. W. 556.

Moreover, in the new company those very assets are valued at upwards of $16,000,000.00 (supra, p. 8) and securities, for that amount, are to be issued therefor.

The corporation was solvent within every acceptation of that term. Its assets at fair valuation exceeded its liabilities and it was able to pay its obligations in due course as they matured, in full.

Non-assenting debentureholders had already brought suit to recover the overdue interest, and that recovery must, nevertheless, be prevented.

On October 1st, 1931, the plan of action was evolved (R., 512-514).

The Reorganization Committee would instruct the Bankers Trust Company to demand the payment of the overdue interest; as trustee, the Bankers Trust Company would demand the payment of all the overdue interest upon all outstanding debentures and as depositary

it would demand the overdue interest upon the deposited debentures. The demand would be refused and then the Reorganization Committee would institute suit for the appointment of receivers and the Bankers Trust Company, as Trustee, would sue to recover judgment for the entire overdue interest.

That was done, and the collection of the overdue interest by the dissenting debentureholders was thus prevented.

The next step in the plan of action was decided upon at a meeting of the Reorganization Committee held on November 28th, 1931 (R., 516-520). At that meeting it was decided that the Reorganization Committee would request Bankers Trust Company to declare the principal of the outstanding debentures due, would demand payment, obtain judgment and would then intervene in the cause as a party plaintiff. The company, of course, would be unable to pay the judgment and its property would, therefore, be sold and non-assenting debentureholders would receive their aliquot share of what the Reorganization Committee would grudgingly pay for that property.

That was done, and the rights of non-assenting creditors were thus wiped out.

Courts of equity are not sanctuaries to which solvent corporations may flee for refuge from their creditors; nor may courts exercise their jurisdiction to hinder, delay and defraud creditors.

> *Harkin* v. *Brundage*, 276 U. S. 36, 52.
> *Michigan* v. *Michigan Trust Co.*, 286 U. S. 334.
> *Shapiro* v. *Wilgus*, 287 U. S. 348.

> "It is insisted that the proceedings were all conducted according to the forms of law. Very likely. Some of the most atrocious frauds are committed

in that way. Indeed, the greater the fraud intended, the more particular the parties to it often are to proceed according to the strictest forms of law."

Graffam v. *Burgess*, 117 U. S. 180, 186.

II.

A court of equity may not exercise its power of sale and distribution over a corporation which is solvent and able to pay its debts as they mature in regular course, in order to effectuate the transfer of those assets to a new company free from the obligations of the old.

It was the purpose of the reorganizers to obtain judicial sanction to the obliteration of non-assenting creditors, through the adoption of legal forms for its accomplishment. To achieve that purpose, the complainants applied to the court to exercise its power of sale and distribution. They made this application, as creditors, to a court of equity. They declared that the corporation was indebted to them in the sum of $567,840.00 (R., 10), the unpaid interest upon the deposited bonds; but they did not demand a judgment upon which they could levy execution. Instead they demanded the sale of all the assets of the company and, pending such sale, the appointment of receivers (R., 12).

If collection of the interest was the object of the suit, then the complainants had a complete and adequate remedy at law and the bill should have been dismissed, for the National Radiator Corporation was solvent and able to pay its debts as they matured.

Section 267 of the Judicial Code.
Oelrichs v. *Spain*, 82 U. S. (15 Wall.) 211.
Lewis v. *Cocks*, 90 U. S. (23 Wall.) 466.
Reynes v. *Dumont*, 130 U. S. 354.

Pusey & Jones Co. v. *Hanssen*, 261 U. S. 491.
Matthews v. *Rodgers*, 284 U. S. 521.

Section 267 of the Judicial Code, Act of March 3, 1911, c. 231, Sec. 267, 36 Stat. 1163; 28 U. S. C. 384, provides as follows:

> "**Suits in equity, when not sustainable.** Suits in equity shall not be sustained in any court of the United States in any case where a plain, adequate, and complete remedy may be had at law."

The mere refusal by a corporation to pay its debts does not vest a court of equity with the power to sell its assets and distribute its proceeds; nor does it confer upon the court the right to appoint receivers thereof pending such sale.

Pusey & Jones Co. v. *Hanssen*, 261 U. S. 491.
Luhrig Collieries Co. v. *Interstate Coal & Dock Co.*, 281 Fed. 265.

In the absence of matters cognizable in equity, a court of equity may not take jurisdiction of a corporation and order its assets sold and its proceeds distributed.

Board of Public Works v. *Columbia College*, 84 U. S. (17 Wall.) 521.
Ager v. *Murray*, 105 U. S. 126.
Freedman's Savings & Trust Company v. *Earle*, 110 U. S. 710.
Scott v. *Neely*, 140 U. S. 106.
Cates v. *Allen*, 149 U. S. 451.
Mississippi Mills v. *Cohn*, 150 U. S. 202.

In the case of an insolvent corporation, its assets are deemed to be held in trust for the benefit of its creditors and a court of equity will take jurisdiction for the pur-

pose of administering that trust. This trust doctrine has been extended to corporations in imminence of insolvency; corporations which, though solvent, would be rendered insolvent if all creditors with debts presently maturing should insist upon immediate payment. But no such trust and no such right exist in the case of a corporation which is solvent and able to pay its debts as they mature in regular course.

Graham v. *Railroad Company*, 102 U. S. 148.
Hollins v. *Brierfield Coal & Iron Company*, 150 U. S. 371.
McDonald v. *Williams*, 174 U. S. 397.
Metropolitan Railway Receivership, 208 U. S. 90.
Pusey & Jones Co. v. *Hanssen*, 261 U. S. 491.
Michigan v. *Michigan Trust Co.*, 286 U. S. 334.
Shapiro v. *Wilgus*, 287 U. S. 348.
Kingsport Press, Inc. v. *Brief English Systems, Inc.*, 54 F. (2d) 497.
May Hosiery Mills, Inc. v. *F. & W. Grand 5-10-25 Cent Stores, Inc.*, 59 F. (2d) 218.
Sidway v. *Missouri Land & Live-Stock Co.*, 101 Fed. 481.
Hutchinson v. *American Palace-Car Co.*, 104 Fed. 182.
United States Shipbuilding Co. v. *Conklin*, 126 Fed. 132.
Zuber v. *Micmac Gold Mining Co.*, 180 Fed. 625.
Burton v. *R. G. Peters Salt & Lumber Co.*, 190 Fed. 262.
Maguire v. *Mortgage Co. of America*, 203 Fed. 858.
Davis v. *Hayden*, 238 Fed. 734.
Myers v. *Occidental Oil Corporation*, 288 Fed. 997.
Willson v. *Waltham Watch Co.*, 293 Fed. 811.

In the instant case there was neither allegation nor proof of insolvency; but there was abundant proof of solvency within every definition of that term. The court therefore lacked jurisdiction and its exercise of jurisdiction was improper.

Grignon's Lessee v. *Astor*, 43 U. S. (2 How.) 319.
Cooper v. *Reynolds*, 77 U. S. (10 Wall.) 308.
Reynes v. *Dumont*, 130 U. S. 354.

Where no jurisdiction exists, it cannot be conferred by consent of the parties.

People's Bank v. *Calhoun*, 102 U. S. 256.
Minnesota v. *Hitchcock*, 185 U. S. 373.
Davis v. *Hayden*, 238 Fed. 734.

It is the prerogative of every corporation to discontinue its business and wind up its affairs. But a corporation may not transfer its assets to a new company and, so disguised, conduct the old business free from the old obligations. Nor can a sale under a consent or collusive decree be used as a subterfuge for a fraudulent conveyance.

Railroad Company v. *Howard*, 74 U. S. (7 Wall.) 392.
Johnson v. *Waters*, 111 U. S. 640.
Chicago, Milwaukee & St. Paul Railway Company v. *Third National Bank of Chicago*, 134 U. S. 276.
Louisville Trust Company v. *Louisville, New Albany & Chicago Railway Company*, 174 U. S. 674.
Northern Pacific Railway Company v. *Boyd*, 228 U. S. 482.

Kansas City Southern Railway Co. v. *Guardian Trust Company*, 240 U. S. 166.

United States v. *Butterworth-Judson Corporation*, 269 U. S. 504.

Kansas City Terminal Railway Company v. *Central Union Trust Company of New York*, 271 U. S. 445.

It is urged (R., 538), however, that although the corporation was solvent on October 5th, 1931, when the bill was filed, it was insolvent or in imminence of insolvency on December 30th, 1931, when the Bankers Trust Company recovered a judgment for the full amount of the principal and unpaid interest upon the outstanding debentures, and that if the court lacked jurisdiction when the bill was filed, that defect was cured by the intervention of the Bankers Trust Company on January 9th, 1932.

If jurisdiction did not exist *ab initio*, the later recovery of the judgment and intervention by the Bankers Trust Company did not invest the court with jurisdiction.

In *Pusey & Jones Co.* v. *Hanssen*, 261 U. S. 491, this Court said at page 501:

> "Respondent contends that, even if there was originally lack of equity jurisdiction, the defect was cured on October 8, 1921, when the intervention of the United States Shipping Board Emergency Fleet Corporation was filed and allowed. That corporation claimed to be a creditor and to have a mortgage lien on all the real estate of The Pusey & Jones Company. The contention is that the original defect in jurisdiction was thus cured, because the existence of a direct lien gives equity jurisdiction for the appointment of receivers, unhampered by the obstacles that confront unsecured simple contract creditors. *The contention is clearly unsound; among*

other reasons, because the intervention did not occur until two months after entry of the decree here under review." (Italics ours.)

Furthermore, the recovery of the judgment and the intervention by the Bankers Trust Company were a part of a collusive scheme to defeat non-assenting debenture-holders of their rights (supra, pp. 11; 14). It is a collusive judgment founded upon the non-payment of interest, for the payment of which there were ample funds and in the non-payment of which the Bankers Trust Company, the National Radiator Corporation and the Reorganization Committee concurred. The judgment was recovered to obviate the defense of insolvency and to furnish an excuse (R., 296-297) for the sale of the assets. Deliberate defaults cannot be laid as the basis for collusive judgments in order to wipe out the rights of creditors.

Johnson v. *Waters*, 111 U. S. 640.
Louisville Trust Company v. *Louisville, New Albany & Chicago Railway Company*, 174 U. S. 674.
Conley v. *International Pump Co.*, 237 Fed. 286.

In a society founded on private ownership, the rights of property must be held sacred and cannot be annulled, except in accordance with established principles of law—common or statutory.

Wilkinson v. *Leland*, 27 U. S. (2 Pet.) 627.
Gunn v. *Barry*, 82 U. S. (15 Wall.) 610.

III.

A court of equity may not exercise its power of sale and distribution over a corporation which is solvent and able to pay its debts as they mature in regular course, for the sole purpose of enabling it to scale its funded debt through reorganization.

In its opinion, the Circuit Court of Appeals said as follows (R., 539):

> "* * * It is the presence of equitable grounds calling for relief in equity which gives the court jurisdiction. *A court of equity is not a forum of convenience to be used by a corporation merely to straighten out its business difficulties or to rebuild its financial structure.* Nor is it a place of refuge to which debtors may go for protection against their creditors and against the remedies of suit, judgment, execution and sale which the law affords them. Debtor corporations are not wards of chancery. There is nothing in the mere fact of a corporation's indebtedness, nor in its inability to pay, nor in its wish to make some composition with its creditors that confers equitable jurisdiction upon a court. It is only when there is something in a situation which sets up an equitable right and admits of equitable relief that parties may go into a court of equity and assert one and obtain the other. Common instances are where a corporation is insolvent or where its insolvency is imminent. * * *" (Italics ours.)

The ground for the exercise of jurisdiction in this case is, in the language of that court, as follows (R., 539-540):

> "* * * The fact that the corporation had in hand sufficient money to meet certain current indebted-

ness did not alter the underlying conditions. Continental & Commercial T. & S. Bank v. Allis-Chalmers Co., 200 Fed. 600, 613; In re Babcock, 26 Fed. (2d) 153. The facts of the situation, showing, as we find, imminence of insolvency and collapse, calling for protection of creditors, constituted a ground of equity for which relief could validly be asked by simple contract creditors within the law of The Pusey & Jones Company v. Hanssen, 261 U. S. 491, and within the warning of Shapiro v. Wilgus, 287 U. S. 348. * * *"

In theory the Circuit Court of Appeals is in accord with us upon the powers of a court of equity; in practice, it is not. That court approved the very things which it condemned; it upheld the power of a court of equity to scale the funded debt of a corporation through reorganization.

The insolvency which it apprehended was not present nor imminent, but contingent and future. It was of the opinion that due to the decline of business brought about by the depression, a continuance of the interest payments would eventually, unless business improved, bring the company to insolvency. **And it was that insolvency which it deemed imminent and sought to avoid.**

The company, in its opinion, was operating at a loss, —much less earning the interest upon the debentures— and it deemed it to the best interests of all concerned, if the corporation would survive the depression, that the interest payments be suspended. Although the company had the funds for the payment of interest, it was the judgment of that court that the cash should be conserved.

Although the plan of reorganization made no provision for the reinstatement of the old debentures upon the revival of business, but permanently cut the principal of those debentures in half and upon that half reduced the

interest, the payment of which itself was contingent on earnings, that court, nevertheless, approved it as a salutary measure.

The sale was employed as a device to effect a transposition of the assets from the old company to the new, in order to free the National Radiator Corporation from the obligations to debentureholders who refused to assent to the plan of reorganization; and the use of that device for that purpose was upheld and approved by that court.

If possible, future insolvency may be laid as the basis for the interposition of a court of equity, then by what touchstone shall such insolvency be tested?

The thesis upon which reorganization rests is that business will improve and that time will convert losses into profits. Otherwise there would be no reason for reorganization and the only reasonable and sane course would be liquidation and distribution of the proceeds. In these circumstances, therefore, who shall say **prospectively** that the losses which may produce such insolvency may not, before the happening of such eventuality, disappear and be replaced by profits? Who shall determine that reorganization is necessary and when it is necessary? If discretion is to be the criterion, who may exercise that discretion, and how may that discretion be controlled and regulated?

The doctrine is novel, unprecedented and pernicious, and to uphold it is to sanction, in times of depression, the suspension of property rights and rights of creditors. If losses in the conduct and operation of a business justify a court of equity to interpose in the affairs of a corporation and to reorganize it, then what company would not in the last three years have been justified to appeal to equity for the granting of such relief?

The doctrine of the lower courts goes beyond even the provisions of statutes enacted for the reorganization of corporations. Such statutes permit such reorganization

only in the event that the corporation is insolvent or is unable to meet its debts as they mature in regular course.

See *National Surety Company* v. *Coriell,* 289 U. S. 426, 437.

The recent amendments to the Bankruptcy Act, Act of March 3rd, 1933, c. 204, Sec. 1, 47 Stat. ——, permitting the reorganization of railroad companies, provide as follows:

> "Reorganization of railroads engaged in interstate commerce. (a) Any railroad corporation may file a petition stating that the railroad corporation is insolvent or unable to meet its debts as they mature and that it desires to effect a plan of reorganization."

A court of equity may no more seize and sell the assets of a solvent corporation than a court of probate may seize and sell the assets of a living person. Physical death confers jurisdiction in the one case, *Scott* v. *McNeal,* 154 U. S. 34; civil death, insolvency, in the other, *Graham* v. *Railroad Company,* 102 U. S. 148.

In *Graham* v. *Railroad Company,* supra, this Court said at page 160:

> "It is contended, however, by the appellant that a corporation debtor does not stand on the same footing as an individual debtor; that, whilst the latter has supreme dominion over his own property, a corporation is a mere trustee, holding its property for the benefit of its stockholders and creditors; and that if it fail to pursue its rights against third persons, whether arising out of fraud or otherwise, it is a breach of trust, and creditors may come into equity to compel an enforcement of the corporate

duty. This, as we understand, is the substance of the position taken.

"We do not concur in this view. It is at war with the notions which we derive from the English law with regard to the nature of corporate bodies. A corporation is a distinct entity. Its affairs are necessarily managed by officers and agents, it is true; but, in law, it is as distinct a being as an individual is, and is entitled to hold property (if not contrary to its charter) as absolutely as an individual can hold it. Its estate is the same, its interest is the same, its possession is the same. Its stockholders may call the officers to account, and may prevent any malversation of funds, or fraudulent disposal of property on their part. But that is done in the exercise of their corporate rights, not adverse to the corporate interests, but coincident with them.

"*When a corporation becomes insolvent, it is so far civilly dead, that its property may be administered as a trust-fund for the benefit of its stockholders and creditors. A court of equity, at the instance of the proper parties, will then make those funds, trust-funds, which, in other circumstances, are as much the absolute property of the corporation, as any man's property is his.*" (Italics ours.)

A court of equity may not seize and sell the assets of a solvent and going corporation merely because its business is unprofitable and losses are sustained in its operation, nor because it is without sufficient funds or resources with which adequately to prosecute its business.

Curtiss v. *Dean & Curtiss*, 85 Wash. 435, 438; 148 Pac. 581.

Worth Manufacturing Co. v. *Bingham*, 116 Fed. 785.

Hirsch v. *Independent Steel Company of America,* 196 Fed. 104, appeal dismissed 225 U. S. 698.

An insolvency which is contingent on earnings and which may occur, if at all, in the future, is not imminent.

Arnold v. *Globe Exchange Bank,* 40 F. (2d) 955, affirmed C. C. A. (2d) 45 F. (2d) 1010.

In *Luhrig Collieries Co.* v. *Interstate Coal & Dock Co.,* 281 Fed. 265, Learned Hand, D. J., describes the conditions which constitute imminent insolvency at page 270 as follows:

> "It was, as I have said, proper enough not to allege insolvency, and in its stead the bill alleged that the corporation was largely indebted and could not pay its debts, that its assets could not be quickly converted, that its creditors were threatening to attach, and had begun to do so, and that, though the assets were enough to pay all, if properly conserved, yet, if no receivers were appointed, they would be dissipated, 'to the great injury of creditors and stockholders'."

In the case at bar there was no pretense that the company was unable to pay its debts. The objection was only to the payment of the interest upon the debentures and the ground of that objection was, in the language of the complaint (R., 11) that:

> "The defendant has no means at hand with which to meet, pay or satisfy the interest charges on the Debentures overdue as aforesaid, without seriously jeopardizing the ability of the defendant to continue its business and without making it difficult or im-

possible for the defendant to secure necessary supplies, materials and labor to continue the operation of its plants and the sale of its products. * * *"

It is conceded by all that the company had *in cash alone* more than sufficient to pay and discharge every debt then due and payable.

Courts are remedial agencies designed to enforce rights and redress wrongs. They may penetrate the form to the substance and may not refuse relief merely because an old wrong wears a modern garb. But they must accept the economy of the society in which they function and recognize the rights and wrongs of the society which has established them. They may not create rights; they may only enforce those which exist.

In *United States* v. *Union Pacific Railroad Company*, 98 U. S. 569, this Court said at page 620:

> "A court of justice is called on to inquire not into the balance of benefits and favors on each side of this controversy, but into the rights of the parties as established by law, as found in their contracts, as recognized by the settled principles of equity, and to decide accordingly. * * *"

In *Treadwell* v. *Salisbury Manufacturing Co.*, 7 Gray (Mass.) 393, Bigelow, J., in defining the powers of a court of equity over corporations, says at 399:

> "Indeed it is too well settled to admit of question, that a court of chancery has no peculiar jurisdiction over corporations, to restrain them in the exercise of their powers, or control their actions, or prevent them from violating their charter, in cases where there is no fraud or breach of trust alleged as the foundation of the claim for equitable relief. Their rights and duties are regulated and governed

by the common law which in most cases furnishes ample remedies for any abuse of corporate powers and privileges, which may injuriously affect either public or private rights. It is only when there is no plain and adequate remedy at law, and a case is presented which entitled a party to equitable relief, under some general head of chancery jurisdiction, that a bill of equity can be maintained against a corporation and this rule is applicable to stockholders as well as to other persons."

See also:

Hardon v. *Newton*, 14 Blatch. 476, 11 Fed. Cases No. 6054.

Myers v. *Occidental Oil Corporation*, 288 Fed. 997.

Republican Mountain Silver Mines v. *Brown*, 58 Fed. 644.

"The first inquiry arising on these facts is, What relief can be given and who is entitled to it?"

United States v. *Union Pacific Railroad Company*, 98 U. S. 569, 610.

Undoubtedly the debtor may not complain that the payment of his debts entails a loss upon him, nor may he ask that the debt be waived or cancelled so that that loss may be avoided. Nor may he demand that, upon payment of the present liquidation value of his assets, he be released from his debts and that he be permitted to retain those assets free from all future liabilities and obligations. The debtor may not (except by composition in bankruptcy) ransom his property by paying to his creditors the present liquidation value thereof,—and es-

pecially not by paying to his creditors what he deems to be the liquidation value thereof.

Sturges v. *Crowninshield*, 17 U. S. (4 Whea.) 122, 197.
Lake St. El. R. Co. v. *Ziegler*, 99 Fed. 114.

Nor may the creditor to whom payment is being made in due course demand that the corporation be wound up and its assets distributed, merely because the operation of that company is unprofitable and he fears the inability of the company to pay, in the future, the obligations which would then mature to him.

United States v. *Union Pacific Railroad Company*, 98 U. S. 590.
Mills v. *Northern Railway Company*, L. R., 5 Ch. App. 621.
Pond v. *Framingham & Lowell R. R. Co.*, 130 Mass. 194.
Worth Mfg. Co. v. *Bingham*, 116 Fed. 785.
Willson v. *Waltham Watch Co.*, 293 Fed. 811.

Where no rights exist, they cannot be created by collusion between the debtor and some friendly creditors.

And the use by the court of its power of sale as a device for freeing the National Radiator Corporation of its obligations to non-assenting creditors is a perversion of its jurisdiction and function. That power—whether in law or in equity—may only be used to enforce payment of genuine debts, honestly matured.

Louisville Trust Company v. *Louisville, New Albany and Chicago Railway Company*, 174 U. S. 674.
Pusey & Jones Co. v. *Hanssen*, 261 U. S. 491.
Ager v. *Murray*, 105 U. S. 126.

Board of Public Works v. *Columbia College*, 84 U. S. (17 Wall.) 521.

Gardner v. *London, Chatham & Dover Railway Company*, L. R., 2 Ch. App. 201.

Burton v. *R. G. Peters Salt & Lumber Co.*, 190 Fed. 262.

Gutterson & Gould v. *Lebanon Iron & Steel Co.*, 151 Fed. 72.

Luhrig Collieries Co. v. *Interstate Coal & Dock Co.*, 281 Fed. 265.

In *Gardner* v. *London, Chatham & Dover Railway Company*, L. R., 2 Ch. App. 201, Sir H. M. Cairns, L. J., said at page 212:

> "Now, I apprehend that nothing is better settled than that this court does not assume the management or undertaking except with a view to the winding up or sale of the business or undertaking. The management is interim management; *its necessity and justification spring out of the jurisdiction to liquidate and sell;* the business or undertaking is managed and continued in order that it may be sold as a going concern and with the sale the management ends." (Italics ours.)

In *Luhrig Collieries Co.* v. *Interstate Coal & Dock Co.*, 281 Fed. 265, Learned Hand, D. J., in defining the nature and purpose of the bill, says at page 270:

> "The origin and nature of the bill stamps it as in rem. It is to reach the assets of the debtor and apply them to the creditors. As such it goes directly against the assets themselves in substitution for attachment and execution."

In the instant case, the court's power of sale was employed not to enforce the rights of creditors but to defeat them; and to enable the debtor to retain possession of its property, free from the obligation to its creditors. The court usurped jurisdiction to enforce a right which did not exist and to grant relief to one who was not entitled thereto.

IV.

The court lacked jurisdiction, and the exercise of jurisdiction by it in this case constituted a taking of property from non-assenting creditors without due process of law, in violation of the Fifth Amendment of the Constitution of the United States.

The suit was instituted not to enforce the payment of debts nor to assure an equitable distribution ratably amongst creditors of the corporation. It was instituted to coerce non-assenting debentureholders to cut their claims in half; to acquiesce in the reduction of the interest; to submit to income bonds; to waive the unpaid interest; and to consent that merchandise and service creditors whose rights were no greater than theirs, should be paid in full. It was instituted not because the corporation was unable to pay its debts, but merely because it found the payment of the interest upon the debentures an inconvenience and hardship. Jurisdiction was assumed and exercised not because of the insolvency of the corporation but merely to enable the corporation, through reorganization, to scale its funded debt.

The plan makes provision for not one dollar of new capital; sacrifices are demanded of none but debentureholders.

But if success should come—no matter how affluent the company may become—the debentureholder is not entitled to have his old claims reinstated, nor to have

the rights which he has surrendered restored. He must submit absolutely to a plan initiated and sponsored by the debtor corporation, or else be wiped out.

We have demonstrated to this Court that jurisdiction for such purposes cannot be sustained under any principles of law or equity and that the exercise of jurisdiction was without authority or sanction.

In *Scott* v. *McNeal*, 154 U. S. 34, this Court said at page 46:

> "No judgment of a court is due process of law, if rendered without jurisdiction in the court, or without notice to the party."

In *Pennoyer* v. *Neff*, 95 U. S. 714, this Court, in defining jurisdiction, said at page 733:

> "* * * Whatever difficulty may be experienced in giving to those terms a definition which will embrace every permissible exertion of power affecting private rights, and exclude such as is forbidden, there can be no doubt of their meaning when applied to judicial proceedings. They then mean a course of legal proceedings according to those rules and principles which have been established in our systems of jurisprudence for the protection and enforcement of private rights. * * *"

See also:

Rhode Island v. *Massachusetts*, 37 U. S. (12 Pet.) 657, 718.
Cooper v. *Reynolds*, 77 U. S. (10 Wall.) 308.
Grignon's Lessee v. *Astor*, 43 U. S. (2 How.) 319, 338.

The court, through the exercise of its jurisdiction, took the property of the non-assenting debentureholders and quite gratuitously gave it to the corporation. Without warrant or justification it extinguished the debentures held by non-assenting holders and released the National Radiator Corporation from its obligations to them; but it approved payment in full to merchandise and service creditors, who ranked equally with non-assenting debentureholders as general creditors of the corporation.

Courts of equity may not by judicial process transfer the property of one corporation to another having the same stockholders, in order to vest in the new company the property of the old free from the old debts. Nor can they sanction a transfer, the very purpose of which was to discriminate between creditors of equal rank.

Railroad Company v. *Howard*, 74 U. S. (7 Wall.) 392.

Northern Pacific Railway Company v. *Boyd*, 228 U. S. 482.

Kansas City Terminal Railway Company v. *Central Union Trust Company of New York*, 271 U. S. 445.

In *Holden* v. *Hardy*, 169 U. S. 366, this Court, in defining due process of law, said at page 390:

> "Recognizing the difficulty in defining, with exactness, the phrase 'due process of law', it is certain that these words imply conformity with natural and inherent principles and justice, and forbid that one man's property or right to property, shall be taken for the benefit of another, or for the benefit of the state, without compensation. * * *"

> "* * * A contract is property. To destroy it wholly or to destroy it partially is to take it; and

to do this by arbitrary legislative action is to do it without due process of law."

Sinking-Fund Cases, 99 U. S. 700, 746.

And to do this by arbitrary judicial action is also to do it without due process of law.

Pennoyer v. *Neff,* 95 U. S. 714.
Scott v. *McNeal,* 154 U. S. 34.
Hovey v. *Elliott,* 167 U. S. 409, 417.

The exercise of jurisdiction in this case violates the fundamental principles of equity and justice and contravenes the due process clause of the Fifth Amendment of the Constitution of the United States.

Conclusion.

There exists an erroneous, but widely held belief, that diversity of citizenship in concatenation with the cabalistic formula, "multiplicity of suits, race of diligence, wasteful strife and controversy" vests in a federal court of equity the power to reorganize corporations and effect under judicial sanction a fraudulent transfer of assets with a commutation of debts. That receivership in creditors' suits is distinctly an ancillary remedy for the enforcement of creditors' rights is being constantly overlooked and the results flowing from the exercise of that remedy have been mistaken for the remedy itself.

Through this misapprehension of the function and purpose of creditors' suits and the appointment of receivers therein, a remedy designed for the prevention of wrongs to creditors has been perverted into a means for the frustration of rights of creditors; and jurisdiction assumed to assure equitable distribution amongst

creditors has, by transformation, been employed to bring about inequitable discrimination against creditors.

Indisputably, this cause was instituted for the purpose of effecting a reorganization of the National Radiator Corporation in accordance with the plan devised by the Reorganization Committee appointed by it.

It is apparent from even a superficial reading of the bill of complaint and the exhibits annexed thereto that the corporation was not insolvent nor threatened with immediate insolvency; that jurisdiction was invoked and receivers appointed to hold at bay debentureholders who refused to assent to the reorganization as planned and demanded payment of the interest upon the debentures they held. It is also apparent that the corporation could have paid to the Reorganization Committee and to the other debentureholders, as well as to every other creditor, every claim then due out of the cash then in its possession. It is evident that not payment but prevention of payment, with the ultimate acquisition of the property, business and assets of the corporation free from the obligation to pay, was the real purpose of the suit.

No reason for the sale of the assets and the distribution of the proceeds was shown and none existed; the appeal was made to the court to employ its power of sale and distribution as a subterfuge in order to accomplish the transfer, to the National Radiator Corporation, disguised in the form of a new corporation, of all its business, property and assets as a going concern, absolved from the obligation to pay its debts to its non-assenting creditors.

The assumption and retention of jurisdiction in the primary cause was a departure from accepted principles of law and constituted a taking of property without due process of law, in violation of the Fifth Amendment of the Constitution of the United States.

The decrees of the Circuit Court of Appeals and the District Court should be reversed and adjudged void as to creditors and debentureholders who have not assented to the plan of reorganization.

In *International Life Insurance Company* v. *Sherman*, 262 U. S. 346, with respect to a situation analogous to the one at bar, this Court said at page 351:

> "The company could not thus be relieved of its obligations to non-consenting annuity certificate holders and have its property returned to it exempt from their claims. Their rights could not be so disposed of. As to them the decree was not a judicial determination and the courts of Missouri were right in holding it to be a nullity. See *Hovey* v. *Elliott*, 167 U. S. 409. *Windsor* v. *McVeigh*, 93 U. S. 274, 277. *McVeigh* v. *United States*, 11 Wall. 259."

Respectfully submitted,

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